

Legislative Fiscal Report

2009 Biennium



Volume 1 – Statewide Perspectives

Presented to the Sixtieth Legislature

Submitted by the
Legislative Fiscal Division

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INTRODUCTION

PURPOSE OF THE REPORT

The purpose of this report is to provide legislators and all interested parties with information regarding the actions of the 2007 Legislature (including both legislation passed and stated legislative intent related to fiscal issues) and the fiscal status of state government through the 2009 biennium. This report seeks to accomplish this by providing an objective perspective on the state's fiscal condition and on the fiscal outcomes of the 2007 regular and special sessions, as well as identifying and providing options for some of the major issues facing the 61st Legislature. In addition, this report is a reference document for all legislators, as well as an historic record of fiscal decisions, and provides a myriad of information about Montana state government.

WHAT IS CONTAINED IN THIS REPORT

The *Legislative Fiscal Report, 2009 Biennium* is published in four volumes. Volumes 2 through 4 report the detailed results of the 2007 Legislature's actions in the regular and special sessions, while Volume 1 presents a broad fiscal overview and a discussion of the most significant fiscal issues, many of which are statewide or cut across program or agency boundaries.

Volume 1

Volume 1, which includes an executive summary, provides an overview of the final budget. *Volume 1* also summarizes significant fiscal issues that may have an impact upon more than one agency or that do not fall under the jurisdiction of a single appropriation subcommittee.

The "2009 Biennium Budget Overview" section on pages 3 through 12 provides a high level summary of the material presented in *Legislative Fiscal Report*.

This volume is structured to present a general fund outlook for the 2007 biennium and 2009 biennium, a summary of the final legislative budget, and a discussion of other fiscal issues that are related to the budget deliberations. The reference section, at the end of *Volume 1*, presents a range of budget-related material. This section is considered especially useful for new legislators and those who have not had direct involvement in the appropriations process.

An index in the back of *Volume 1* is the most comprehensive for the purpose of searching for information in all four volumes.

Volume 2

Volume 2 includes a summary and overview of the state's major revenue sources. A review of the table of contents will give the reader a quick idea of revenue sources included and the structure of the report. This volume delineates the economic assumptions used to derive revenue estimates

adopted by the Revenue and Taxation Interim Committee (RTIC) and introduced in the revenue estimate bill (HJR 2). It also describes the legislative actions that affected the various revenue sources.

Volumes 3 and 4

Volumes 3 and 4 offer detailed discussions of the appropriations established by the legislature for each agency and program in state government that receives an appropriation in HB 2. Agency presentations are grouped in sections corresponding to the appropriations subcommittee addressing the agency.

Volume 3 contains: House Bill 2 (the general appropriation act)
Section A – General Government and Transportation, and
Section B – Health and Human Services

Volume 4 contains: Section C – Natural Resources and Commerce,
Section D – Corrections and Public Safety,
Section E – Education, and
Section F - Long-Range Planning

A specific agency can be located in any of three ways. The general index included in each volume provides an alphabetical listing of agencies and other topics, in conjunction with appropriate volume and page numbers. If the subcommittee addressing a given agency is known, the cover page of each section lists agencies, in order by appearance. Agency names are also visible on page headings within their respective sections.

Volumes 3 and 4 briefly describe the agencies from all three branches of state government, as well as each program within an agency. The basic structure used for the report is consistent across agencies. These volumes detail an agency's appropriations, both in tables and narrative. These volumes present detailed discussions of present law adjustments, new proposals, new legislation, and significant fiscal issues by agency as identified by fiscal staff.

Agency budgets are presented in three tiers as required by statute:

1. **Base budget:** the level of funding authorized by the previous legislature;
2. **Present law base:** the additional level of funding needed under present law to maintain operations and services at the level authorized by the previous legislature; and
3. **New proposals:** requests to provide new non-mandated services, to change program services, to eliminate existing services, or to change sources of funding.

By making this presentation in this tiered manner, the reader is able to see how the budget evolved from the base budget to the total amount appropriated, and the incremental increases or decreases that make up the total budget.

Proprietary Rate Setting

The 1995 legislature, in HB 576, removed the requirement that proprietary – or internal service and enterprise – funds be appropriated by the legislature. Instead, as provided in Section 17-8-101, MCA, the legislature approves the rates charged for those particular services and products. It also requires the Office of Budget and Program Planning to submit a report as part of the Executive Budget. The proprietary rates that the legislature approved can be found in Section R of HB 2 (located at the beginning of Volume 3). There are also brief discussions of the rates in the relevant agency sections.



THE BIG PICTURE – AN EXECUTIVE SUMMARY

PURPOSE/CHALLENGES

PURPOSE

The purpose of this section is to provide an executive summary of the highlights of Volume 1, “Statewide Perspective”. It is intended to provide a stand-alone, big picture understanding of the state budget outlook for the 2009 biennium, for the general fund in particular and the legislative budget solution. This includes a look at the following:

- Major fiscal challenges that the legislature needed to address in the 2007 session
- The fiscal outlook for the state general fund (how much money was available, and why?)
- The legislature’s major initiatives to address budget challenges and its priorities
- Issues related to the legislative budget as adopted

The details behind the information presented in this section are discussed in more detail in the body of this volume, and readers are encouraged to delve into more detailed explanations of these issues to better understand the budget challenges and issues the legislature addressed in crafting the 2009 biennium state budget priorities.

GENERAL FUND OUTLOOK?

Following a biennium (2005) in which significant service reductions were taken, some major revenue sources have taken a surprising turn. Bolstered by greater than expected individual and corporate income tax collections and higher oil prices, state revenues increased significantly, leaving a sizable projected fund balance as of the end of FY 2007. However, there was also strong pressure for increased funding for assorted state services. Even though there were record funds available in the state’s general fund, prioritization of spending and the appropriate level of budget spending was a hotly contested issue. There were significant budget challenges that the legislature addressed in setting the budget priorities for the 2009 biennium. Those challenges are listed here with a more detailed discussion in the following section:

- Is K-12 education adequately funded?
- Does this budget control health care costs and increase access?
- How are correction costs for overpopulation addressed?
- Can college tuition increases be slowed to improve affordability?
- Are state employees fairly compensated and does the pay plan retain a quality workforce?
- Will all pension plans be actuarially sound?
- How will the state catch up on maintenance of state facilities?
- Is the public defender fully funded?
- Can the state mitigate adverse litigation outcomes?
- How will the state mitigate lost federal funds?

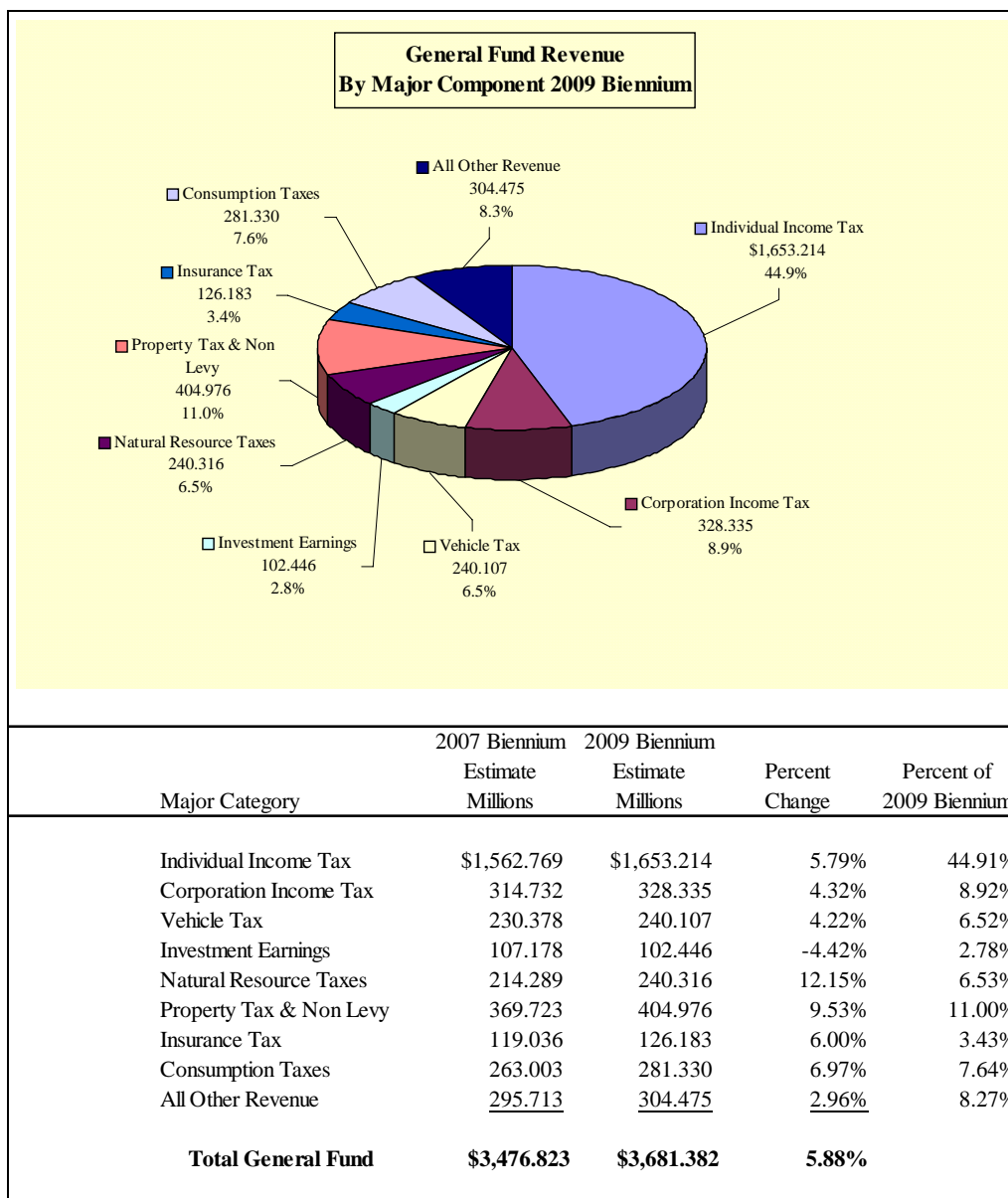
- Is long-term budget stability attainable?
- What is an adequate fiscal safety net?
- How can the state mitigate uncertainties in budgeting?
- How can spending without legislative scrutiny be limited?

With these challenges (not all-inclusive) as a background, the following sections discuss the revenues available to address these issues and the legislature's actions to deal with these issues and other priorities of the legislature.

GENERAL FUND OUTLOOK

This section summarizes briefly the source of general fund revenues, the total funds available coming into the 2007 session, and the expenditures to fund a present law budget.

WHERE DOES THE REVENUE COME FROM?



Personal and corporate income and property taxes comprise 65 percent of the total \$3.7 billion in general fund revenues.

WHAT WERE THE AVAILABLE FUNDS FOR THE 2007 SESSION?

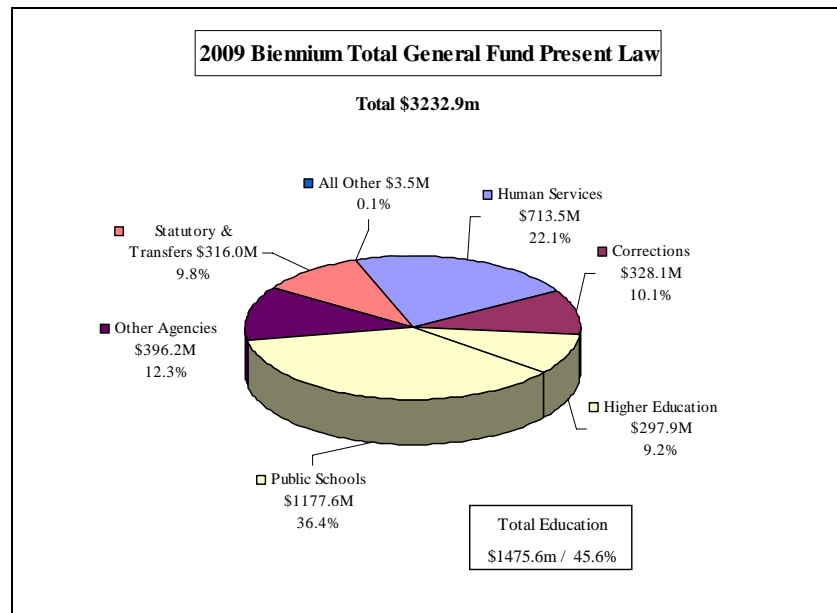
Projected ending fund balance after funding present law

- With estimated revenues of \$3.7 billion and a beginning fund balance of \$0.5 billion, a total of \$4.2 billion was available
- The legislature appropriated \$3.2 billion to fund a present law budget
- After funding the present law budget, \$963.7 million was available for tax policy changes, spending initiatives, and fund balance reserves

| 2009 Biennium General Fund Balance Present Law Only (In Millions) | | | |
|--|--------------------------|--------------------------|----------------------------|
| | Estimated Fiscal 2008 | Estimated Fiscal 2009 | Estimated 2009 Biennium |
| Beginning Fund Balance | \$523.595 | \$722.265 | \$523.595 |
| Revenues | | | |
| Current Law Revenue | <u>1,797.764</u> | <u>1,875.209</u> | <u>3,672.973</u> |
| Total Funds Available | \$2,321.359 | \$2,597.474 | \$4,196.568 |
| Disbursements | | | |
| General Appropriations | | | |
| Human Services | 348.992 | 364.544 | 713.536 |
| Corrections | 159.850 | 168.251 | 328.101 |
| Higher Education | 148.160 | 149.778 | 297.938 |
| Public Schools | 587.203 | 590.410 | 1,177.613 |
| Other Agencies | 197.968 | 198.222 | 396.190 |
| Statutory Appropriations | 148.719 | 148.864 | 297.583 |
| Non-Budgeted Transfers | 9.126 | 9.310 | 18.436 |
| Feed Bill Appropriations | 2.280 | 8.740 | 11.020 |
| Anticipated Reversions | <u>(3.204)</u> | <u>(4.344)</u> | <u>(7.548)</u> |
| Total Disbursements | \$1,599.094 | \$1,633.775 | \$3,232.869 |
| Ending Fund Balance Before Reserve | \$722.265 | \$963.699 | \$963.699 |

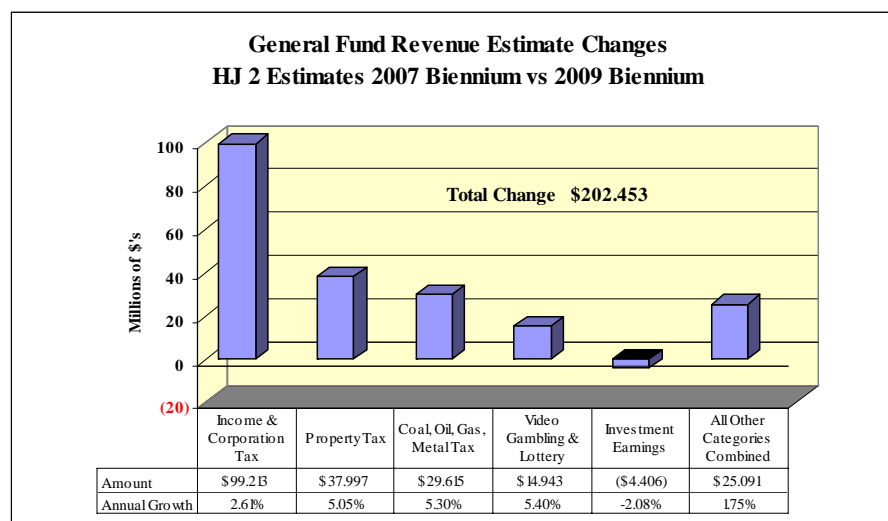
What is present law?

- The cost of providing the same level of services authorized by the previous legislature
- Education, human services, and public safety consume 78 percent of general fund monies
- Local government entitlements, debt service, and other statutory requirements obligate almost 10 percent of general fund monies



Why so much available funds after funding present law?

- Unprecedented growth in:
 - Individual income tax
 - Corporation income tax
 - Oil and natural gas production tax



- Cautionary Note: growth in these categories could be subject to future corrections
 - Individual income tax – high level of capital gains income that may be an anomaly due to land and other real estate sales
 - Corporate income tax – volatile source - current projections at all-time high are highly influenced by the natural resource sector
 - Oil and gas production tax– Based on record production and price levels - What is the long-term trend for a finite commodity and the world energy market

The next section describes the legislature's solution to available funds of nearly \$1 billion after funding

LEGISLATIVE BUDGET HIGHLIGHTS

As shown in the previous section, the legislature had \$4.2 billion in available revenues. After authorizing base expenditures of \$2.8 billion and present law adjustments of \$0.4 billion (\$413 million), the legislature had nearly \$1 billion (\$964 million) in funds available to fund tax policy changes, spending initiatives, and fund balance reserves.

The following figure shows the legislative allocation of the \$963.7 million of available funds for new initiatives and fund balance, which included \$14.7 million in net revenue increases and \$794.7 million in disbursements (including tax rebates and other tax policy initiatives), and leaving a general fund balance reserve of \$183.8 million.

| 2009 Biennium General Fund Budget Legislative Initiatives Above Present Law (In Millions) | |
|--|----------------------------|
| | Estimated 2009 Biennium |
| Beginning Present Law Balance | \$963.699 |
| Legislative Revenue Proposals | |
| Revenue Bills With Impacts | 14.711 |
| Total Revenue Proposals | \$14.711 |
| Legislative Disbursement Proposals | |
| New Proposals in HB2 (Includes Pay Plan & Retirement Adjustments) | |
| Human Services | 73.659 |
| Corrections | 18.133 |
| Higher Education | 67.699 |
| Public Schools | 147.069 |
| Other Agencies | 48.919 |
| Pay Plan Contingency & Training | 3.076 |
| Long Range Planning | 193.588 |
| Tax Modifications | |
| Property Tax Rebate | 98.730 |
| Water Tax Rebate | 25.000 |
| Retirement Systems | |
| Retirement Rate Increase | 24.731 |
| TRS Retirement Cash Transfer | 50.000 |
| Miscellaneous Other Proposals | |
| Defined Benefit Loan Repayment | 1.400 |
| Issue \$400 Rebate Cost | 1.028 |
| Collect Out-of-State Debt Cost | 1.617 |
| Montana Community Health Support | 1.300 |
| Children's Trust Fund | 1.000 |
| Cultural Arts Trust | 1.500 |
| Military Family Relief | 1.000 |
| Blackfeet Tribe Water Compact | 15.000 |
| Repay Land Trusts | 1.315 |
| County Attorney Salaries | 4.688 |
| Optional Retirement Program | 2.256 |
| Revise Firefighter Retirement Laws | 1.928 |
| Fish & Hunt For Free | 0.815 |
| Noxious Weeds Trust | 5.000 |
| Other Proposals <= \$500,000 | 4.168 |
| Total Disbursement Proposals | \$794.619 |
| Total Legislative New Proposals (Revenue & Disbursements) | (\$779.908) |
| Ending Balance Before Fund Balance Reserve | \$183.791 |

As shown in the figure, the legislative budget includes a net \$14.7 million in additional revenues generated by new legislation, including authorization for the Department of Revenue to collect additional out-of-state tax debts, an endowment credit in SB 150, and tax gains from the issuance of a property tax rebate.

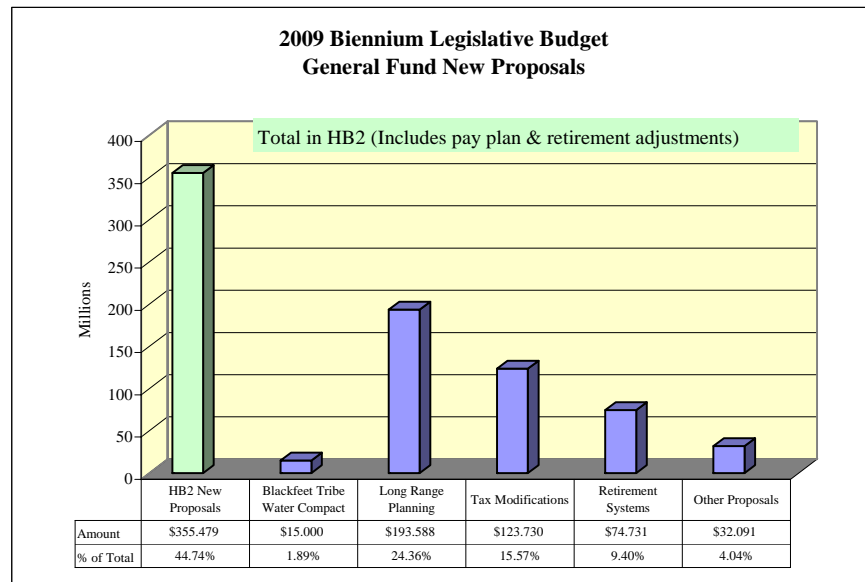
New proposals in HB 2 and HB 13 (pay plan) authorized over \$355 million in new initiatives, summarized as follows:

- Human Services -- \$73.7 million, primarily for expanded Medicaid mental health services eligibility and provider rate increases
- Corrections -- \$18.1 million to exempt some staff from vacancy savings, IT, and sex offender incarceration
- Higher Education -- \$67.7 million, primarily to provide sufficient state funding to cap tuition cost increases for the 2009 biennium (increased state share) and a number of other initiatives
- Public Schools -- \$147.1 million, including funding for full-day kindergarten, an increase in the quality educator payment, and property tax relief
- Other Agencies (general government, natural resources) -- \$48.9 million, including a significant increase for the Department of Revenue for increased compliance initiatives and reappraisal, litigation expenses, and various initiatives in the Judiciary and Department of Justice

Other new initiatives included:

- \$193.6 million for capital projects in the long range planning program, including the decision to fund nearly all projects on a cash basis versus the issuance of bonds, and an infusion of funds to reduce a significant backlog in funding for state infrastructure maintenance
- Tax initiatives of \$123.7 million, which includes a property tax rebate (\$98.7 million) that will result in a \$400 rebate for homeowners, and a rebate of the water tax based on rescinding the tax on wells approved in HB 22 in the 2005 legislative session
- \$74.7 million for a reduction in the unfunded liability in the retirement systems, including a \$50 million cash infusion into the teacher's retirement system, and a \$24.7 million increase in the employer's (state) share of retirement fund contributions
- \$15 million for negotiation of the Blackfeet Tribe Water Compact
- \$32.1 million in other miscellaneous initiatives, including \$5.0 million for the noxious weeds trust fund, and \$4.7 million due to change in funding mechanism for county attorney salaries,

The major categories of new initiatives described above are graphically depicted in the following chart.



The legislature allocated \$183.8 million as an ending fund balance reserve. This is an unprecedented reserve, comparable to a high of under \$80 million projected for the 2007 biennium. The Governor had recommended an ending reserve of \$100 million, with the balance to go to a rainy day fund. The bill authorizing a rainy day fund did not pass the legislature. For the first time, the state has a reserve of over 5 percent of general fund revenues, which is important since the legislature does not budget up-front for spiraling wildfire suppression costs, and the executive openly stated that supplemental requests for corrections and other programs (were likely) in the 2009 biennium. The unexpended reserve represents just under 20 percent of the available funds after funding present law.

OTHER FEATURES OF THE LEGISLATIVE BUDGET

There are a myriad of issues that are discussed in more detail in various parts of the *Legislative Fiscal Report*. While these issues all relate to the overall legislative budget, some relate to statewide budget or policy issues, and some relate to budget process itself. Regardless, the following lists those issues in a brief format that are not presented above to make the reader aware of the bigger picture. However, for more detail the reader will need to dig deeper. (The table of contents or index should provide a quick link to more detailed discussion.) The legislative budget includes:

- Supplemental appropriations in FY 2007 of \$83.3 million general fund
- A pay plan with a 3 percent per year salary increase beginning October 1 each year, and an increase in insurance contributions each year
- Making the “broadband pay plan” the state’s primary compensation system
- Increases in FTE of 412.08 in FY 2008 and 385.58 in FY 2009 over the FY 2006 level
- Present law adjustments of \$413 million
- Specific action to address potential future K-12 legal action
- As discussed above, maintaining a \$184 million fund balance as a buffer to unforeseen expenditure needs or revenue shortfalls

ISSUES WITH LEGISLATIVE BUDGET

The following is a list of the more significant issues that should be considered when evaluating the approved budget for the 2009 biennium.

- There is a significant expansion of state programs and services
- The ongoing transfer of funds from the general fund to other funds for a specific purpose reduces future legislative oversight of those general fund moneys
- There are issues with regard to measurable goals and objectives for the budget increases requested. Further, the Governor line-item vetoed the legislative initiative to require updates on achievement of budget performance measures (accountability) from most agencies
- The highways special revenue account fund balance is not sustainable in the long term, and future federal funding levels for highways is uncertain
- The State Fund “old fund” is underfunded and will eventually have to be supported by general fund
- Legislators need to be aware of pending lawsuits related to the State Fund, lease payments by dam owners, and protested taxes that all have general fund implications
- The long-term stability of the general fund is an issue that must be examined for development of sound fiscal policies
- Regarding the state’s reliance on federal funds, the prospect for federal funding freezes or reductions is a real possibility, not only in the near-term but also in the long-term
- Regarding wildfire suppression, there are two issues: 1) the cost of suppression operations has increased dramatically; and 2) federal participation is declining. Further, the legislature does not budget up-front for these costs